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BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission
DOCKETED
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COMMISSIONERS

GARY PIERCE, Chairman
BOB STUMP
SANDRA D. KENNEDY
PAUL NEWMAN
BRENDA BURNS

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR A HEARING TO DETERMINE THE FAIR VALUE OF THE UTILITY PROPERTY OF THE COMPANY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, TO APPROVE RATE SCHEDULES DESIGNED TO DEVELOP SUCH RETURN	Docket No. E-01345A-11-0224 **NOTICE OF FILING DIRECT TESTIMONY (SETTLEMENT AGREEMENT) OF KEVIN C. HIGGINS ON BEHALF OF FREEPORT-MCMORAN COPPER & GOLD INC. AND ARIZONANS FOR ELECTRIC CHOICE AND COMPETITION**

Freeport-McMoRan Copper & Gold Inc. and Arizonans for Electric Choice and Competition (collectively "AECC"), hereby submit the Direct Testimony (Settlement Agreement) of Kevin C. Higgins on behalf of AECC in the above captioned Docket.

RESPECTFULLY SUBMITTED this 18th day of January 2012.

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FENNEMORE CRAIG
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BEFORE THE ARIZONA CORPORATION COMMISSION

In the Matter of the Application of Arizona Public Service Company for a Hearing to Determine the Fair Value of the Utility Property of the Company for Ratemaking Purposes, to Fix a Just and Reasonable Rate of Return Thereon, to Approve Rate Schedules Designed to Develop Such Return	)))))))	Docket No. E-01345A-11-0224

Direct Testimony of Kevin C. Higgins

on behalf of

Freeport-McMoRan Copper & Gold Inc. and

Arizonans for Electric Choice & Competition

Settlement Agreement

January 18, 2012

DIRECT TESTIMONY OF KEVIN C. HIGGINS

SETTLEMENT AGREEMENT

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DIRECT TESTIMONY OF KEVIN C. HIGGINS

SETTLEMENT AGREEMENT

INTRODUCTION

Q. Please state your name and business address.

A. Kevin C. Higgins, 215 South State Street, Suite 200, Salt Lake City, Utah, 84111.

Q. Are you the same Kevin C. Higgins who previously pre-filed direct testimony in this proceeding on behalf of Freeport-McMoRan Copper & Gold Inc. and AECC (collectively "AECC") on the topics of revenue requirement and cost of service/rate design?

A. Yes, I am. I described my qualifications in my revenue requirements testimony. A more detailed description of my qualifications is contained in Appendix A, attached to that testimony.

OVERVIEW AND CONCLUSIONS

Q. What is the purpose of your settlement testimony?

A. I am testifying in support of the Proposed Settlement Agreement ("Agreement") filed by the ACC Staff on behalf of the Agreement's Signatories on January 6, 2012. The proposed Agreement provides a comprehensive resolution of the issues in the Arizona Public Service Company ("APS") general rate case.

Q. Were you personally involved in the negotiations that resulted in the Agreement?

A. Yes, I participated in the negotiations on behalf of AECC.

Q. What is your recommendation to the Commission with respect to the Agreement?

A. I recommend that the Agreement as submitted by the Signatories be approved by the Commission. In my opinion, the Agreement produces just and reasonable rates and is in the public interest.

Q. Does AECC support the entire Agreement?

A. Yes. The Agreement is a package that was crafted after extensive negotiations among many parties over several weeks. AECC is recommending adoption of each provision in the Agreement as a package deal.

Q. How is your testimony in support of the Agreement organized?

A. First, I offer some comments on the overall Agreement. I follow that discussion with some specific comments on certain provisions of the Agreement that are of particular interest to AECC.

<u>OVERALL AGREEMENT</u>

Q. Please provide a general overview as to why you believe the Agreement is in the public interest and should be adopted.

A. AECC is a customer group. Accordingly, I participated in the Settlement Agreement negotiations from the vantage point of customers in general, with a particular emphasis on the perspective of business customers. In providing a comprehensive resolution of the issues in the APS general rate case, the Agreement offers the following key benefits to customers:

- It results in an overall zero dollar base rate increase versus the $95.5 million base rate increase proposed by APS in its direct filing;
- It ensures a zero percent overall bill impact for the remainder of 2012 versus the $194.1 million overall rate increase proposed by APS in its direct filing – after taking account of the reset of the current Power Supply Adjustor ("PSA") credit to near zero that would have otherwise occurred upon the implementation of new rates by July 2012;
- It requires a four-year rate case stay out, pursuant to which APS agrees not to raise base rates as a result of any new general rate case filing until at least mid-2016, whereas APS would otherwise have been permitted to file a rate case after June 1, 2013 per the terms of the Settlement Agreement approved in Docket No. 01345A-08-0172;
- It includes a buy-through rate option for industrial and large commercial customers which will provide an opportunity for Arizona businesses to improve their economic health through energy cost savings – at no risk to other customers;
- It provides a narrowly-tailored Lost Fixed Cost Recovery ("LFCR") mechanism in lieu of the full revenue decoupling proposed by APS, while offering an opt-out rate design for residential customers who choose not to participate in the LFCR. For customers with billing demands of 400 kW or greater, the settlement agreement addresses through rate design APS's concerns over fixed cost recovery associated with energy efficiency investments.

- It provides a defined and equitable path forward for the recovery of costs associated with any acquisition by APS of Southern California Edison's share of Four Corners Units 4-5, if the Commission finds the Four Corners transaction to be prudent.
- It requires APS to file a request to reduce the System Benefit Charge ("SBC") to reflect a corresponding reduction of the decommissioning trust funding obligations collected through the SBC related to the full funding of Palo Verde Nuclear Generating Station ("PVNGS") Unit 2, which is expected to occur by the end of 2015. APS is required to make the filing in sufficient time for the reduction to occur by January 2016.

Taken as a whole, the Settlement Agreement provides meaningful protections and benefits to customers while providing APS the opportunity to earn a fair return.

Q. In your direct testimony you challenged several aspects of APS's filing that have been included in the settlement package, such as APS's proposal to remove the sharing percentage in the PSA and the Company's proposal to include 100 percent of APS-owned solar generation in base rates, including costs above the Market Cost of Comparable Conventional Generation. Have you changed your testimony on these matters?

A. I have not changed my opinion on these topics as isolated matters or when these topics are viewed in the context of APS's initial application. However, the overall settlement package contains enough benefits to customers that I have concluded that it is in the public interest to move forward with this entire package, including certain items with which I may disagree in isolation. Such is the nature of negotiation and compromise.

With respect to removing the sharing percentage in the PSA, I note that the Settlement Agreement requires APS to adhere to a four-year stay-out from general rate cases. I participate in general rate cases around the country; in many jurisdictions they have become annual events. A four-year stay-out is extraordinary in today's regulatory environment and conveys a very significant benefit to customers in terms of rate stability and rate certainty. APS's willingness to adhere to a stay-out of this length strongly influenced AECC's willingness to concede its litigation position on the PSA sharing percentage in this case.

In accepting a different ratemaking treatment of APS-owned solar generation than I had recommended in my direct testimony, AECC has given considerable weight to the overall zero dollar base rate increase, zero percent overall bill impact for the remainder of 2012, and the general service rate design that are included in the Settlement Agreement. Taken as a whole, these components, in combination with the rest of the Agreement, constitute a reasonable resolution to the overall case, including the ratemaking treatment of APS-owned solar generation.

DISCUSSION OF SPECIFIC ISSUES

Q. In your direct testimony you recommended that APS's revenue requirement for its base rates be reduced by at least $75.4 million prior to taking into account adjustments that may be offered by other parties with respect to

return on equity or other revenue requirement items not addressed in your testimony. Does the Settlement Agreement adequately address the revenue requirement issues you raised in your direct testimony?

A. Yes. The Settlement Agreement reduces APS's proposed base rate increase by $95.5 million. The $75.4 million reduction recommended in my direct testimony is subsumed in this amount.

Q. In your direct testimony you also recommended that APS's System Benefits Charge be reduced by $8.704 million per year to better reflect the reduction in decommissioning costs associated with the PVNGS life extension. Does the Settlement Agreement adequately address this issue?

A. Yes, but in a different manner than I had proposed in my direct testimony. As I stated in my direct testimony, APS has been granted approval by the Nuclear Regulatory Commission to extend the life of PVNGS by twenty years. This life extension through the 2045-47 time frame causes two fundamental impacts on the funds that must be accrued for the purpose of nuclear decommissioning: (1) it increases the total amount of money projected to be required to complete the decommissioning, due, in large part, to the expectation that decommissioning costs will be more expensive in the future because of inflation; and (2) it extends the time for contributions to be made to the sinking fund required to pay for the decommissioning, and similarly, extends the time that interest can be earned on the balance in the sinking fund. *As a general proposition*, the net effect of these two impacts is that the annual contribution to the sinking fund necessary to pay for the decommissioning decreases significantly when the life of the facility is extended. However, this does not occur for PVNGS 2.

According to the terms of a sale/leaseback transaction that APS entered for PVNGS 2, all decommissioning costs must be paid in full by 2015. With the life of the PVNGS being extended, this special funding provision causes an <u>increase</u> in annual decommissioning expense for Unit 2, rather than an annual decrease, as occurs for PVNGS 1 and 3, which have decades longer to accrue the full funding needed for decommissioning with the life extension.

In my direct testimony, I recommended that the decommissioning expense charged to customers for PVNGS 2 be rolled back to the pre-life-extension annual expense of $6.047 million (total Company) from the post-life-extension annual expense of $14.968 million (total Company). I recommended that this level of expense in rates should remain in place until the 2015 expiration of the sale/leaseback terms, at which time it should be reset to assure full recovery from customers of the remaining decommissioning obligation, plus reimbursement of any funding provided by APS between 2012 and 2015 to cover the gap between the funds provided by customers and the decommissioning funding requirements of the sale/leaseback transaction.

In the Settlement Agreement the decommissioning expense charged to customers for PVNGS 2 is not rolled back; however, the Settlement Agreement expressly calls out that the PVNGS 2 decommissioning expense will drop precipitously to zero after 2015 and requires APS to file with the Commission to reset the SBC at a lower level to reflect these savings effective January 2016.

This alternative approach reasonably and adequately addresses the issue raised in my direct testimony.

Q. In your direct testimony you recommended that the Commission reject APS's decoupling proposal for all customers. You also went on to testify that if some form of revenue decoupling is approved by the Commission, that customers with billing demands greater than 400 kW should be excluded from the program because rate design could be used to insulate APS from loss of fixed-cost recovery from energy conservation for customers of this size. Does the Settlement Agreement adequately address this issue?

A. Yes. As I discussed above, the Settlement Agreement proposes a narrowly-tailored LFCR mechanism in lieu of revenue decoupling. At the same time it offers an opt-out rate design for residential customers who choose not to participate in the LFCR. For customers with billing demands of 400 kW or greater, the settlement agreement uses rate design to address APS's concerns over fixed cost recovery associated with energy efficiency investments, consistent with the recommendations in my direct testimony.

In my view, this compromise proposal, which relies on many features proposed by Staff in its direct testimony, is vastly superior to the full decoupling mechanism that had been proposed by the Company. First of all, any recovery of fixed costs through this mechanism is limited to fixed-costs associated with reductions attributable to energy efficiency and distributed generation; lost fixed costs attributable to other factors, such as weather and general economic conditions are excluded. This limitation addresses one of AECC's primary critiques of full revenue decoupling.

Secondly, the LFCR is limited to a portion of distribution and transmission costs and excludes costs recovered through the Basic Service Charge and 50 percent of the distribution and transmission costs that are recovered through non-generation/non-TCA demand charges; this limitation appropriately recognizes that revenues from such charges are not as sensitive to changes in usage attributable to energy efficiency as are energy charges.

Thirdly, Residential customers have the ability to opt-out of the LFCR through an alternative rate design. This provides greater flexibility to customers.

And fourthly, the Settlement Agreement appropriately recognizes that concerns over fixed-cost recovery can be adequately addressed for larger customers through rate design, specifically by setting Basic Service Charges and demand charges to align properly with APS's fixed costs.

Q. In your direct testimony you opposed adoption of APS's proposed Environmental and Reliability Account. Does the Settlement Agreement adequately address this issue?

A. Yes. Pursuant to the terms of the Settlement Agreement, the Company's proposal for an Environmental and Reliability Account is withdrawn. Moreover, the existing Environmental Improvement Surcharge will be revised and reset to zero on the effective date of new rates.

Q. In your direct testimony you supported APS's proposal to implement Experimental Rate Rider AG-1. How does the Settlement Agreement deal with Rate Rider AG-1?

A. The Settlement Agreement adopts Rate Rider AG-1, as refined by the Stipulating Parties in the settlement negotiations. Rate Rider AG-1 allows qualifying customers with aggregated monthly demands of 10 MW or more to obtain alternative sources of generation to serve their full power requirements.

APS will purchase and manage the generation on behalf of the customer for a management fee of $0.0006 per kWh.

The settlement discussions provided an opportunity for interested parties to fill in the details to make AG-1 workable while adhering to the original "buy-through" concept proposed by APS; in a buy-through transaction, in contrast to direct access, the utility acts as the middleman between customer and the market.

Q. What is your assessment of Rate Rider AG-1?

A. Rate Rider AG-1 is a very customer-friendly innovation. It has the potential to enable Arizona businesses to improve their economic health through energy cost savings – at no risk to other customers. Because it is an experimental rate rider, participation will be limited to 200 MW. Consequently, it will be necessary to develop a fair and efficient lottery process to use in the event AG-1 becomes over-subscribed.

Q. Do you believe that Experimental Rate Rider AG-1 can be a good substitute for a policy of reinstating direct access service in Arizona?

A. No, I do not see that as its purpose. AECC continues to advocate for reactivation of direct access service in Arizona. However, that issue is outside the purview of this proceeding. In the meantime, Experimental Rate Rider AG-1 can provide substantial benefits to customers through the buy-through option.

Q. In your direct testimony you objected to APS's proposed spread of rates. Does the Settlement Agreement adequately address this issue?

A. Yes. The zero base rate increase – combined with the zero percent overall bill impact for the remainder of 2012 – allays my concerns regarding the spread of rates. Moreover, the rate impacts from the eventual reset of the PSA credit in February 2013 is reasonably mitigated through the equalization of the percentage bill impact across General Service customers.

The Settlement Agreement also provides for an adjustment rider to recover the rate base and non-PSA related expenses associated with any acquisition by APS of Southern California Edison's share of Four Corners Units 4-5 on an equal percentage basis across all rate schedules. This provision offers a defined and equitable path forward for recovery of these potential costs if the Commission finds the Four Corners transaction to be prudent.

Q. Does this conclude your settlement testimony?

A. Yes, it does.